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SENSITIVE
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STATE FOR NEA/ELA, NEA/RA AND
USAID FOR ANE/MEA MCCLOUD AND RILEY
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TREASURY FOR MATHIASON AND DENNIS
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SUBJECT: INFLATION RISES IN JUNE, BUT NOT AS FAST AS IN PREVIOUS MONTHS

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¶1. (U) Inflation reached 20.2% year-on-year (YoY) in June, up from 19.7% YoY in May, according to Egypt's Central Agency for Public Mobilization and Statistics (CAPMAS). Food prices increased 27.2% YoY, up slightly from 27% YoY in May. Speaking just before release of the inflation figures, Minister of Economic Development Othman told the press that the price of some items - fruits, meat, tomatoes and chicken - actually decreased in June. Focusing on the positive, Othman noted that month-on-month (MoM) food and beverage prices rose only 0.8% in June, down from 3.6% MoM in May. Overall MoM inflation was only 0.6% in June, compared to an average MoM increase of 5.5% in the first five months of 2008. For FY2007-08 (which ended 30 June), inflation averaged 11.7% YoY, up from 11% YoY in FY2006-07, according to Othman.

¶2. (U) Anticipating continued inflationary pressure, the Central Bank (CBE) raised interest rates by 50 basis points in late June, to 10.5% (deposit) and 12.5% (lending). A statement by CBE's Monetary Policy Committee indicated that as food prices continue to rise, the spillover to non-food prices remains strong, as does the pass through effect from adjustments to the fuel subsidy in early May. While several banks, notably National Bank of Egypt, raised deposit rates accordingly, the CBE interest rate hike is likely to have little impact overall, due to the continued high liquidity in the banking system. Most analysts assert that appreciation of the Egyptian pound against the U.S. dollar would slow inflation more effectively than interest rate hikes.

¶3. (SBU) Comment: While the relatively low increase in inflation in June is a positive development, inflation is likely to remain high in the medium term. Ramadan begins in September this year, and food prices have historically risen during the fasting month. This year, as last, Ramadan also coincides with the beginning of the academic year, when families spend more than normal on school supplies. Media reports about bread lines have decreased significantly, as the GOE's separation of bread production from distribution appears to have reduced the black market for subsidized wheat. In late June, the GOE announced plans to form a committee to develop the bread subsidy system, including public bakeries and distribution points, signaling that the government doesn't plan to alter the food subsidy system in the near future.

SCOBAY